

124 FERC ¶ 61,141
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Southern Star Central Gas Pipeline, Inc.

Docket No. CP08-4-001

ORDER GRANTING REHEARING
AND AMENDING CERTIFICATE AUTHORIZATION

(Issued August 5, 2008)

I. Background

1. On May 9, 2008, the Commission issued an order granting in part an application by Southern Star Central Gas Pipeline, Inc. (Southern Star) for certificate authorization under section 7(c) of the Natural Gas Act (NGA) to construct facilities and acquire additional property rights to expand the certificated boundaries of its South Welda Storage Field (South Welda) in Anderson County, Kansas, in order to recover gas migrating out of storage.¹ This order on rehearing grants a request filed by Southern Star on May 30, 2008, for additional certificate authority to acquire certain other property rights requested in its original application to ensure the successful implementation of its plan for the recovery of migrated storage gas.²

2. The South Welda gas storage field in Anderson County, Kansas has a maximum certificated storage capacity of approximately 18.3 Bcf, including a working gas capacity of 6.7 Bcf. South Welda and two other gas storage fields (the North Welda Storage Field

¹ *Southern Star Central Gas Pipeline, Inc.*, 123 FERC ¶ 61,138 (2008) (May 9 Order).

² Southern Star styled its May 30, 2008 pleading as a petition for clarification. However, Southern Star seeks additional certificate authority and its request therefore goes beyond the scope of clarification. Accordingly, the Commission is treating the pleading as a request for rehearing of the May 9, 2008 certificate order. On June 9, 2008, the Commission issued a tolling order in Docket No. CP08-4-001 to provide additional time for consideration of the Southern Star request.

and the Colony Storage Field) comprise Southern Star's Welda storage complex. The three storage fields are geologically connected by the Colony Sandstone formation which is laterally continuous across the Welda storage complex. Southern Star stores gas within the Colony Sandstone formation in the three storage fields. South Welda's certificated boundaries include approximately 7,900 acres.

3. The Colony Sandstone was originally developed as a gas production field in the early 1920s and has been utilized for gas storage by Southern Star and its predecessors since 1937. As a result of ongoing monitoring and the requirements of Kansas statutes and regulations, Southern Star had a contractor perform an integrated geologic and engineering study of the Colony Sandstone formation at the South Welda field to identify specific storage field characteristics.

4. The Colony Sandstone certificated for Southern Star's storage of gas is the lowest portion of the Upper Cherokee formation, which begins approximately 800 feet below the surface. The Upper Cherokee formation includes other formations. Above the Colony Sandstone, in which gas is stored, are the Lower and Upper Squirrel Sandstones. Between the Colony Sandstone and the Lower Squirrel Sandstone and between the Lower Squirrel Sandstone and the Upper Squirrel Sandstone are shale and siltstone.

5. The shale and siltstone should form a non-permeable barrier and, along with the Squirrel Sandstone layers in the Upper Cherokee, historically have been classified as the confining layer or cap rock above the Colony Sandstone storage area. However, the study prepared by Southern Star's consultant revealed that gas is migrating upward from the Colony Sandstone. The study reports that, as a result of both ongoing oil operations since the 1940s and early storage well completion practices of the late 1970s, pathways have been created for storage gas to migrate upward from the Colony Sandstone into the oil-bearing Squirrel Sandstone of the Upper Cherokee. Consequently, gas has migrated into the overlying oil-production areas and, in some oil wells, is being produced along with oil.

6. On October 5, 2007, Southern Star filed its application in this proceeding for certificate authority to enable it (1) to acquire property rights to expand South Welda's certificated boundaries both laterally and vertically to prevent further oil production activities that could further compromise the integrity of the storage field; and (2) to install a system to recover migrating storage gas and re-inject it into the Colony Sandstone. The Commission's May 9 Order granted Southern Star certificate authority to reclassify the cap rock for the South Welda storage area so that it is above the Squirrel Sandstones to ensure that Southern Star can acquire the necessary property interests (through eminent domain, if necessary) to gain control of the Squirrel Sandstones. The Commission concluded that the certificate authority granted by the May 9 Order to expand South Welda's certificated vertical boundaries would be sufficient to enable Southern Star to

gain control of the Squirrel Sandstones and prevent the continuation of oil production activities that are recovering its migrated storage gas. Further, the certificate granted by the May 9 Order included authority for Southern Star to acquire 11 existing oil wells so that they can be converted to gas recovery wells in accord with Southern Star's plan to recover gas that migrates up into Squirrel Sandstones.³ The May 9 Order denied Southern Star's request for additional certificate authority to also expand South Welda's certificated boundaries laterally, finding the record did not demonstrate the presence of migrated storage gas in those areas.

7. When the Commission issued its May 9, 2008 certificate authority, it did not believe it had been clearly shown that continued oil production from the overlying Squirrel Sandstones, into which storage gas is upwardly migrating, or from formations above the Squirrel Sandstones, without jeopardizing Southern Star's recovery of migrating gas was entirely infeasible. Therefore, the May 9 Order did not grant Southern Star's request for certificate authority that would enable it to acquire all rights and interests, including surface rights, in the five oil leases above South Welda's certificated boundaries.⁴

II. Southern Star's Request for Rehearing

8. In its request for rehearing, Southern Star asserts that in granting certificate authority for it to acquire only the specific 11 oil wells identified for use in its gas recovery plan, but not the five oil leases above its South Welda storage field in their entirety, the Commission's May 9 Order may conflict with oil and gas law and the law of eminent domain in the state of Kansas. In any event, Southern Star says that in order to control the Squirrel Sandstone, it must acquire all mineral interests with production rights in the Squirrel Sandstone, including the mineral owners' and the lessees/operators' interests. Southern Star also asserts that, in addition to the 11 oil wells that the May 9 Order authorized it to acquire, it needs to acquire all the other existing oil wells so that they may be plugged, operated as observation wells, or connected to its gas recovery system.

³ As identified in the May 9, 2008 certificate, at n. 29, the 11 oil wells to be used in the gas recovery system are RW-6 (SWB-56), RW-8 (SWB-58), RW-9 (SWB-54), RW-10 (SWB-55) and RW-12 (SWB-53) within the Unit # 3 Lease in section 3; Peine R1 in section 28; Knoeppel in section 32; Well # 30/4 in section 10; Brecheisen # 510 in the Brecheisen Lease; and Cooper # 14 and # 15 on the Cooper Lease.

⁴ The five leases Southern Star seeks to acquire in their entirety are the Cooper Lease, Unit #3 Lease, Buchanan Lease, Tinsley Lease, and Brecheisen Lease.

9. Southern Star recognizes that the Commission's rationale for limiting the relief granted to Southern Star was based on an attempt to balance Southern Star's storage needs against the interests of other property interests. However, Southern Star emphasizes that the only viable means of continued oil production is through the use of water flooding techniques, which will further compromise the integrity of the South Welda storage field and exacerbate the migration of storage gas into the Squirrel Sandstones.

10. Accordingly, on rehearing, Southern Star seeks amendment of the certificate authority granted by the Commission's May 9 Order to enable Southern Star to acquire all mineral and leasehold interests, including (1) the right to produce oil from the Squirrel Sandstone within the South Welda certificated boundary; and (2) any wells in addition to the 11 specified by the May 8, 2008 order that have been completed in the Squirrel Sandstone. Southern Star states that, as to the additional wells it seeks to acquire, the only surface rights it seeks to acquire in conjunction with the mineral interests would be those surface rights associated with allowing it the right of ingress and egress for any existing oil wells it acquires.

11. On rehearing, Southern Star also seeks the certificate authority requested in its application allowing it to proceed with connecting any of the existing oil wells to its gas recovery system, converting some of the oil wells to observation wells, and plugging any remaining oil wells.

III. Kansas Corporation Commission's Comments

12. On June 17, 2008, the Kansas Corporation Commission (Kansas Commission) filed comments in support of Southern Star's request for rehearing. The Kansas Commission states it is apparent that the interests of the oil producers within the certificated boundary of the South Welda field are in direct conflict with Southern Star's interests, and that this conflict presents significant economic, environmental, and safety issues. In order to strike an appropriate balance between the oil producers and Southern Star's natural gas storage operations, the Kansas Commission says that a reasonable accommodation of the competing interests and a solution to a long-standing problem is for Southern Star to acquire the oil mineral owners' interests, as proposed by Southern Star.

IV. Analysis

13. In our May 9 Order, we found that the record demonstrated that storage gas is migrating up from Southern Star's South Welda storage field into the overlying Squirrel Sandstones. That finding provided the basis for reclassifying the South Welda cap rock so that all of the Upper Cherokee above the Colony Sandstone in which Southern Star's

gas is stored will become part of South Welda's certificated storage reservoir. Thus, while the May 9 Order does not authorize Southern Star to inject any storage gas into the Squirrel Sandstones, pursuant to the order those formations will become part of the storage field's buffer area. Accordingly, the May 9 Order gives Southern Star the right to acquire through eminent domain all property interests in the Upper Cherokee, including any oil in the Squirrel Sandstones, enabling Southern Star to prevent oil production activities that could further compromise the integrity of the South Welda storage facility.⁵ The May 9 Order also gives Southern Star the right to acquire 11 existing wells identified in its application for use in its system to recover storage gas that migrates into the Squirrel Sandstones.⁶

14. On rehearing, Southern Star has explained that the only viable means of continued production of oil from the Squirrel Sandstones is through the use of water flooding techniques, which would lead to more fracturing and permeability, thereby exacerbating the gas migration problem. The Kansas Commission, the state agency with regulatory authority over oil production and the oil wells that will not be used in Southern Star's natural gas operations, supports Southern Star's request on rehearing for additional certificate authority to acquire the existing oil leases in their entirety. As noted above, the Kansas Commission states that Southern Star's and the oil producers' conflicting

⁵ Although our May 9 Order raised the certificated boundary of South Weda vertically to the top of the Upper Cherokee, to the extent there was any potential for oil production from zones above or below the certificated boundaries, mineral interest owners would still have the right to have these formations explored for oil.

⁶ In support of its argument on rehearing that we should grant certificate authority for Southern Star to acquire the five oil leases, including all existing oil wells, above its South Welda storage area, Southern Star asserts that oil and gas law and the law of eminent domain in the state of Kansas may not accommodate Southern Star's acquiring only the 11 oil wells certificated by our May 9 Order. While we are granting Southern Star authority on rehearing to acquire all interests in the five leases, including surface rights and additional wells, we do so as a practical matter, since Southern Star and the Kansas Commission have convinced us that continued oil production from the Squirrel Sandstones above Southern Star's South Welda storage gas is not economically feasible, thus rendering the leases valueless. If we were not convinced that any further oil production is infeasible, we would continue to limit Southern Star's certificate authority accordingly. Our decision here rests on the evidence that continued oil production from these particular wells would be inconsistent with Southern Star's storage operations, rather than the legal proposition that the leases cannot be divided under state law.

interests present significant economic, environmental, and safety issues, and that Southern Star's proposal to acquire all oil production rights and existing oil wells and to cooperate with the Kansas Commission to ensure that wells are plugged properly would be a reasonable accommodation of competing interests and a solution to a long-standing problem.⁷

15. Southern Star's acquisition of the property rights necessary to prevent further oil production activities, install an effective gas recovery system, and ensure proper plugging of oil wells will ensure that migrated storage gas will no longer be vented into the atmosphere. Southern Star's acquisition of these rights and compensation to the owners as determined by the court will avoid periodic litigation between Southern Star and the owners of the oil interests in the state courts. Finally, the Commission notes that none of the owners of these oil rights have intervened or filed comments in this proceeding.

16. In view of the above considerations, we will amend the certificate granted by our May 9 Order to include authority for Southern Star to acquire all interests, including both the mineral owners' interests and the lessees/operators' interests in their entirety, in all strata underlying the certificated surface boundary of the South Welda Storage Field, including but not limited to the Squirrel Sandstones and the rest of the Upper Cherokee certificated by the May 9 Order as a buffer area for the gas storage area in the underlying Colony Sandstone.⁸

17. Our May 9 Order applied the Certificate Policy Statement,⁹ and found that Southern Star's installation of a gas recovery system that utilizes existing oil wells and additional compression and its acquisition of property rights to enlarge its certificated

⁷ As discussed in the May 9 Order, the Kansas Commission, as well as the Kansas Department of Health and Environment, have expressed environmental and safety concerns over oil producers venting, instead of flaring, gas that has migrated out of Southern Star's storage facilities.

⁸ Southern Star explains in its request for rehearing that it is not sufficient for it simply to acquire and "hold" all oil lessors/operators' property interests to produce oil from the Squirrel Sandstones. That is because Southern Star's failure to produce oil and pay royalties to the mineral owners would cause the leases to expire, and the mineral owners would then be able to grant leases to new operators.

⁹ *Certification of New Interstate Natural Gas Pipeline Facilities*, 88 FERC ¶ 61,227, at 61,748 (1999); *order on clarification*, 90 FERC ¶ 61,128 (2000); *order on clarification*, 92 FERC ¶ 61,094 (2000) (Certificate Policy Statement).

storage reservoir are necessary to ensure that it will be able to continue providing reliable storage services for its customers using the South Welda storage facility. As stated in the May 9 Order, increasing the rates of existing customers to pay for these kinds of improvements is not a subsidy and the costs of such projects are permitted to be rolled in a future rate proceeding.¹⁰ The amendment of Southern Star's certificate by this order on rehearing is in the public interest to ensure that Southern Star can acquire all the property interests necessary to prevent the South Welda storage field's integrity from being further compromised. Therefore, we affirm that Southern Star is entitled, absent a material change in circumstances, to a presumption of rolled-in rate treatment for this project's costs when it initiates a future section 4 rate proceeding to recover the costs.¹¹

18. As noted above, the May 9 Order certificated Southern Star's acquisition of 11 existing oil wells and incorporation of those specific oil wells into its proposed gas recovery system for recapturing storage gas that has migrated into the Squirrel Sandstones and re-injecting the gas into the Colony Sandstone. The additional certificate authority granted by this order on rehearing will result in the other existing oil wells in the Squirrel Sandstones having no further utility for oil production. However, Southern Star has not adequately explained what it will do with the additional oil wells this order authorizes it to acquire. Southern Star states that it may want to use some of the oil wells in its gas recovery system or as observation wells and that it will plug any other wells, after obtaining the Kansas Commission's approval. We will require Southern Star to file, within 90 days, a plan setting forth what it proposes to do with all the existing oil wells not certificated by the May 9 Order for its gas recovery system.

¹⁰ *Id.*, 88 FERC at 61,746. See also, e.g., *Southern Star Central Gas Pipeline, Inc.*, 115 FERC ¶ 61,219 (2006).

¹¹ Exhibit K to Southern Star's October 5, 2007 certificate application showed total estimated project costs of \$6,432,841, including construction costs and costs to acquire additional property interests. As amended by this order on rehearing, Southern Star's project is authorized as originally proposed, except for its request to also expand the boundaries of its Welda Storage field laterally into areas where the May 9 Order found there was insufficient record evidence of the presence of migrated storage gas. (Southern Star does not seek rehearing of our denial of certificate authority for lateral expansion.) Because of increases in Southern Star's estimated costs for its acquisition of property interests as authorized by the May 9 Order and by this order on rehearing, Southern Star states its estimated total project costs have increased by approximately 4 percent.

19. Southern Star's planned activities with respect to the wells may be authorized by section 157.213 of the Part 157 blanket certificate regulations. However, if Southern Star chooses to proceed under the blanket certificate regulations, it must do so under the prior notice provisions, and project costs may not exceed the cost limit in section 157.208(d) (\$29,000,000 for Calendar Year 2008).¹² Construction activities to convert or plug the oil wells cannot be segmented to meet the blanket certificate regulations' cost limit.

20. Further, whether Southern Star files its proposal under the blanket certificate regulations' prior notice provisions or in an application for case-specific certificate authority, Southern Star will be required to satisfy certain consultation requirements. Specifically, Southern Star must consult with the U.S. Fish and Wildlife Service, the Kansas State Historic Preservation Officer, the Kansas Department of Wildlife and Parks, and the Kansas Commission to develop and implement procedures to avoid effects to threatened or endangered wildlife or historic properties that might result from plugging or converting these wells. This order's grant of certificate authority for Southern Star to acquire additional interest in property does not affect findings in the May 9 Order that approval of Southern Star's project would not constitute a major Federal action significantly affecting the quality of the human environment.

21. The Commission on its own motion received and made a part of the record in this proceeding all evidence, including the application and exhibits thereto, submitted in support of the authorizations sought herein, and upon consideration of the record,

The Commission orders:

(A) Southern Star's request for rehearing is granted by the amendment of its certificate issued by the May 9 Order in this proceeding to include additional certificate authority to acquire property interests, as discussed herein.

(B) The certificate authority granted by Ordering Paragraph (A) above is conditioned on Southern Star filing, within 90 days, a plan in accordance with the discussion herein setting forth its proposal with respect to the existing oil wells to be acquired. Southern Star shall consult with the U.S. Fish and Wildlife Service, the Kansas State Historic Preservation Officer, the Kansas Department of Wildlife and Parks, and the KCC to develop and implement procedures to avoid effects to threatened or endangered wildlife or historic properties that might result from the plugging or conversion of wells.

¹² 18 C.F.R. § 157.1 *et seq.* (2008).

(C) When Southern Star files under section 4 of the NGA to recover the costs of the construction and acquisition of property interests as authorized by the certificate granted by the May 9 Order in this proceeding and amended herein, there shall be a presumption of rolled-in rate treatment for such costs, absent a material change in circumstances.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.